No. 2671

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

JOHN E. MANDERS, as trustee in bankruptcy of the estates of Peterson & Wilson, a partnership, and G. Hazelton Wilson and George Peterson, individuals, bankrupts,
Appellant,

vs.

GEORGE H. WILSON and ELLA H. WILSON (his wife),
Appellees.

BRIEF FOR APPELLANT.

REUBEN G. HUNT,
Attorney for Appellant.

Filed this.....day of May, 1916.

FRANK D. MONCKTON, Clerk.

By.....Deputy Clerk.

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Statement of the Case.

This is an appeal from the judgment of the District Court for the Northern District of California sustaining a demurrer to appellant's complaint and dismissing an action brought by appellant, as trustee in bankruptcy, for the purpose of setting aside a certain transfer of real property, under the provisions of Sec. 70e of the Bankruptcy Act taken in conjunction with Sec. 23b of the same act.

The complaint alleges, in substance, as follows:

That the appellees are husband and wife, and the individual bankrupt G. Hazelton Wilson is their son; that appellant is the duly appointed, qualified and acting trustee in bankruptcy of the estates of Peterson & Wilson, a partnership, and of the said G. Hazelton Wilson and George Peterson, individuals and members of the partnership;

That on the 27th day of September, 1911, and for a long time prior thereto, the said individual bankrupt G. Hazelton Wilson was the sole owner of, and in the actual possession of, the real property involved, and appeared upon the records as such owner, and continuously thereafter until the 23rd day of October, 1914, appeared upon such records as such sole owner;

That on the said 27th day of September, 1911, the said individual bankrupt G. Hazelton Wilson executed and delivered to the appellees a deed to this real property either in payment of an antecedent indebtedness of $2000.00 or as a mortgage to secure the repayment of the same; that this deed remained in the possession of appellee George H. Wilson from the said 27th day of September, 1911, until the said 23rd day of October, 1914, when it was recorded for the first time; that from said 27th day of September, 1911, until said 23rd day of October, 1914, a period of three years, the said individual bankrupt G. Hazelton Wilson was in the open, notorious and exclusive possession of the said

real property and the reputed and apparent owner thereof;

That appellees did not have possession of the said real property, or any part thereof, and were not the reputed or apparent owners, until after the said 23rd day of October, 1914; that appellees withheld the said deed from record in order not to affect the credit of the said individual bankrupt G. Hazelton Wilson, or the credit of the said bankrupt partnership, and in order to enable the said bankrupt partnership to extend its credit upon the reputed and apparent ownership of the property in the said individual bankrupt G. Hazelton Wilson;

That on the 6th day of July, 1914, the said bankrupt partnership and the said individual bankrupt G. Hazelton Wilson falsely and fraudulently represented to the New England Casualty Co., a corporation, that the said bankrupt partnership was the owner of, and in the possession of, the said real property, without any encumbrance thereon, through and by the said individual bankrupt G. Hazelton Wilson, as disclosed by the record; and that, relying upon the said representation, and not otherwise, and without knowledge of its falsity, the said corporation extended credit to the said bankrupt partnership, but, prior to bankruptcy and the recording of the deed, suffered loss by reason of such extension of credit, not discovering the falsity of the representation until the recording of the deed as aforesaid;

That the real property involved is worth about $2000; and that the assets of the bankruptcy estates are insufficient to pay the creditors in full.

To this complaint, the appellees interposed a general and special demurrer, but this demurrer raised but one point, namely, that no fraud is alleged in connection with the original execution and delivery of the deed, and that, therefore, the complaint does not state facts sufficient to constitute a cause of action.

Brief of the Argument.

I. *A deed not at first fraudulent may afterwards become so if withheld from record for the purpose of enabling the grantor to extend his credit upon his apparent unencumbered ownership of the property as disclosed by the record.*

National Bank of Athens v. Shackelford, 31 Am. B. R. 464, 208 Fed. Rep. 677;

Peterson v. Mettler, 29 Am. B. R. 160, 162, 198 Fed. Rep. 938;

Blennerhasset v. Sherman, 105 U. S. 100, 26 Law Ed. 1080, and cases there cited and discussed;

Adams v. Curtis, 36 N. E. Rep. 1095, 1097;

Clayton v.Exchange Bank of Macon, 10 Am. B. R. 178, 179, 121 Fed. Rep. 630;

Bank of the U. S. v. Housman et al. (N. Y.), 6 Paige Ch. 526, 538;

Political Code of Cal., Sec. 1214.

II. *Necessary elements of estoppel such as would prevent appellees from asserting title are set forth in the complaint.*

Bashore v. Parker, 146 Cal. 525, 530;
Code of Civ. Proc. of Cal., Sec. 1962, Subd. 3;
16 Cyc., 774;
Filipini v. Trobock, 134 Cal. 441.

III. *The transfer was one that any creditor of the bankrupt might have avoided in the California courts had bankruptcy not intervened, and comes, therefore, within the purview of Section 70e of the Bankruptcy Act.*

Bankruptcy Act, Sec. 70e;
Civ. Code of Cal., Sec. 1214;
Political Code of Cal., Sec. 4468;
Bush v. Helbing, 134 Cal. 676, 681.

Argument.

I.

A DEED NOT AT FIRST FRAUDULENT MAY AFTERWARDS BECOME SO IF WITHHELD FROM RECORD FOR THE PURPOSE OF ENABLING THE GRANTOR TO EXTEND HIS CREDIT UPON HIS APPARENT UNENCUMBERED OWNERSHIP OF THE PROPERTY AS DISCLOSED BY THE RECORD.

That this is the rule of the English Common Law, and also of many of the States, appears from an examination of the authorities which we cited on page 4 above in the brief of the argument.

In the case of Hungerford v. Earle, 2 Vern. 261, it was held that

> "a deed not at first fraudulent may afterwards become so by being concealed or not pursued, by which means creditors are drawn in to lend their money".

This case is typical of the other English cases upon the subject.

In this country, a typical case is that of Peterson v. Mettler, 29 Am. B. R. 160, 162; 198 Fed. Rep. 938, where the court, at pp. 939, 940 of 198 Fed. Rep. said:

> "While the evidence tends to show that there was an actual agreement between Simon and Carl to withhold the deeds from record, cases even go so far as to hold that such an agreement is not necessarily present to empower the trustee to set aside the conveyance.
>
> With the transfer of the property kept off the records for a most unreasonable time, whether wilfully and according to agreement between the two brothers, as appears from the record, or negligently, as Carl would have us believe, with no visible change in the possession of the property, and with creditors advancing money on the faith of the record and representations of Simon, the way would be open to the deceitful and fraudulent, so that property rights would be insecure."

The District Judge, in his opinion in the case at bar, said:

> "Whatever may be the rule in other states, or at the common law, no law, nor any decision

> has been called to my attention which would permit the corporation extending credit to the grantor to avoid a deed not otherwise fraudulent in this State, because of failure to record it" (Trans. p. 11).

In this statement, he overlooks the fact that the fraud alleged in the complaint is not merely the failure to record, but the failure to record in order not to affect the credit of the grantor, and in order to enable him to extend his credit upon the reputed ownership of the property involved (Trans. p. 5 and p. 11).

He also overlooks the further fact that there is no law or decision in California that *denies* relief for the species of fraud alleged in the complaint, and that, in this situation, the rule of the English Common Law furnishes the law of the case, by reason of the express provision of Sec. 4468 of the Political Code of California, which provides:

> "The common law of England, so far as it is not repugnant to or inconsistent with the constitution of the United States, or the constitution or laws of this State, is the rule of decision in all courts of this State."

It is apparent, therefore, that in the absence of any law or decision to the contrary in California, and this must be admitted by appellees for there is no such law or decision to be found, that the rule of the English common law must prevail: the rule expressed in in the cases of Hungerford v. Earle, supra, and Peterson v. Mettler, supra.

II.

NECESSARY ELEMENTS OF ESTOPPEL SUCH AS WOULD PREVENT APPELLEES FROM ASSERTING TITLE ARE SET FORTH IN THE COMPLAINT.

The District Judge in his opinion in the case at bar said (Trans. p. 12):

> "Nor does there appear in the complaint the necessary elements of an estoppel such as would prevent the defendants from asserting title".

What are the necessary elements of an estoppel? In the case of Bashore v. Parker, 146 Cal. 525, it was said at p. 530:

> "The instruction, moreover, eliminates from consideration the necessary elements of an estoppel as laid down by Subdivision 3 of Section 1926 of the Code of Civil Procedure."

This subdivision provides:

> "Whenever a party has, by his own declaration, act, or omission, intentionally and deliberately led another to believe a particular thing true, and to act upon such belief, he cannot, in any litigation arising out of such declaration, act, or omission, be permitted to falsify it".

Now what are the facts alleged in the case at bar? It is alleged (Trans. pp. 4-5):

> "On the 27th day of September, 1911, and for a long time prior thereto, the above-named bankrupt G. Hazelton Wilson was the sole owner of, and in the actual possession of, and appeared upon the records of the hereinafter-mentioned County of Alameda as the sole owner of, and continuously thereafter until the 23rd day of October, 1914, appeared upon the said

records as the sole owner of, the following described real property (here follows description, the property being in Alameda County, California).

Thereafter and on said 27th day of September, 1911, the said bankrupt G. Hazelton Wilson executed and delivered to defendant George H. Wilson, his father, and to defendant Ella H. Wilson, his mother, a deed to the said real property. * * * The said deed remained in the possession of the said George H. Wilson from the said 27th day of September, 1911, until the 23rd day of October, 1914, and was not placed on record until the said 23rd day of October, 1914, when it was recorded in the office of the County Recorder of said County of Alameda. * * *

At and during all the dates and times herein mentioned down to and including the 23rd day of October, 1914, the day when the said deed was recorded, the said bankrupt G. Hazelton Wilson was in open, notorious and exclusive possession of the said real property and was the reputed and apparent owner thereof, and neither the said George H. Wilson nor the said Ella H. Wilson ever had possession of the said real property, or was the reputed or apparent owner thereof, at or during any of said dates or times. The said deed was withheld from record as aforesaid by the said defendant George H. Wilson and the said defendant Ella H. Wilson in order not to affect the credit of the said bankrupt G. Hazelton Wilson, and the credit of the said bankrupt partnership, and in order to enable the said bankrupt partnership to extend its credit upon the reputed and apparent ownership of the said real property in the said bankrupt G. Hazelton Wilson."

Are these allegations not equivalent to a statement that appellees intentionally and deliberately omitted to record the deed in order to lead the creditors of the bankrupts to believe that a particular thing was true, to-wit: The property belonged to the bankrupts?

It is further shown in paragraph VIII of the complaint (Trans. pp. 5-8) that a creditor of the bankrupts was misled into believing, by reason of such failure to record, that the property belonged to the bankrupts, and that, acting in good faith upon this belief, it extended credit to the bankrupts, something it would not have done had it known the true state of affairs, and that by reason of such extension of credit it suffered loss prior to the bankruptcy proceedings.

The rule is stated in Cyc. as follows (16 Cyc. 774):

> "The owner of real property may, by clothing another with an apparent title thereto, or with an apparent authority over it, estop himself to deny such title or authority."

See also the case of Filipini v. Trobock, 134 Cal. 441.

We submit, therefore, that, in view of the allegations of the complaint and these authorities, the District Judge was in error in his conclusion that the necessary elements of an estoppel were not set forth.

III.

THE TRANSFER WAS ONE THAT ANY CREDITOR OF THE BANKRUPT MIGHT HAVE AVOIDED IN THE CALIFORNIA COURTS HAD BANKRUPTCY NOT INTERVENED, AND COMES, THEREFORE, WITHIN THE PURVIEW OF SECTION 70e OF THE BANKRUPTCY ACT.

Sec. 70e of the Bankruptcy Act provides as follows:

> "The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of the adjudication."

This, of course, means "which any creditor of such bankrupt might have avoided" under the laws of the State where the transaction occurred, which, in the case at bar, is California. The District Judge in his opinion in the case at bar (Trans. pp. 11-12) stated that:

> "Whatever may be the rule in other states, or at the common law, no law, nor any decision has been called to my attention which would permit the corporation extending credit to the grantor to avoid a deed not otherwise fraudulent in this State, because of failure to record it. Indeed it was early held here that failure to record a transfer of real property renders such transfer void only as against subsequent purchasers or incumbrancers in good faith and for value. Section 1214, Civil Code; Prow v. Rose, 4 Cal. 173; Pixley v. Higgins, 15 Cal. 127."

Section 1214 of the Civil Code, referred to by the District Judge, provides:

> "Every conveyance of real property, other than a lease for a term not exceeding one year, is void as against any subsequent purchaser or mortgagee of the same property, or any part thereof, in good faith and for a valuable consideration, whose conveyance is first duly recorded, and as against any judgment affecting the title, unless such conveyance shall have been duly recorded prior to the record of notice of action."

Evidently the District Judge assumed that this section applied to all cases, irrespective of whether fraud was present or not. Section 3439 of the Civil Code of California provides:

> "Every transfer of property or charge made thereon, every obligation incurred, and every judicial proceeding taken, with intent to delay or defraud any creditor or other person of his demands, is void against all creditors of the debtor, and their successors in interest, and against any person upon whom the estate of the debtor devolves in trust for the benefit of others than the debtor".

If the theory of the District Judge be correct, therefore, an unrecorded deed would not be void as against a creditor, even though the transfer was made with intend to delay or defraud, because he is not a subsequent purchaser or encumbrancer.

It was held in the case of Bush v. Helbing, 134 Cal. 676, 681, that the fact that a deed is kept secret and not recorded is a very potent badge of fraud,

and this was one of the principal grounds in that case for the avoidance of the deed in question by the attacking creditor. Yet if the theory of the District Judge be correct, the attacking creditor in that case would have no standing by reason of the non-recording of the deed, because he was not a subsequent purchaser or encumbrancer.

It is quite apparent that the District Judge was mistaken in his theory. Sec. 1214 of the Civil Code was not intended to be exclusive, or else Sec. 3439 would not have been enacted; and Sec. 1214 plainly does not apply to cases where fraud is present.

It is true that Sec. 3439 applies only to fraud in the inception of the transaction, and not to a situation like the one in the case at bar. There is no statute upon the subject in California, nor is there any decision of its courts bearing upon the question, unless it be certain statements in the case of Bush v. Helbing, 134 Cal. 676, where it is said at p. 681:

> "The fact that a deed is kept secret and not recorded is a very potent badge of fraud. In Francis v. Lawrence, 48 N. J. Eq. 511, the wife retained a deed, and the husband obtained credit by representing that he was the owner of the house and lot conveyed. In speaking of the transaction the court said: 'At the time of these representations, except the first, his wife was in possession of a conveyance of the property from him to his brother-in-law, for the purpose of vesting the title in her name. The deed was not delivered to the grantee and not placed upon the record, but was held by the wife, and the husband was thus enabled to trade upon the false credit which he acquired by

> being the apparent owner of the property, while the deed was ready to be put upon the record at a moment's notice. * * * This transaction cannot be regarded in any other light than as a fraud upon the creditors.' * * *
>
> * * * It is said by Bigelow (Vol. 2, p. 365): The case would be different, however, if the creditors were induced to give credit on the faith of the ownership of the possessor, where the real owner has neglected to put his deed on record. It is enough to bar the claim of the owner that his neglect or (to avoid any possible misunderstanding) his omission has contributed to the deception of the creditors."

Does the lack of a law or a decision upon the subject in California preclude the creditors, as claimed by the District Judge? Sec. 4468 of the Political Code of California provides:

> "The common law of England, so far as it is not repugnant to or inconsistent with the constitution of the United States, or the constitution or laws of this State, is the rule of decision in all the courts of this State."

As we have seen (p. 5 of this brief), under the common law a transfer not at first fraudulent may afterwards become so where it is kept off the records for a most unreasonable time, with no visible change in the possession of the property and with creditors advancing money upon the faith of the record.

This rule of the common law, then, would be the rule of the California courts in the absence of any law or decision to the contrary. We have been

unable to find any such law or decision and are quite confident that appellees will have the same difficulty. On the contrary, the statements in the case of Bush v. Helbing above referred to, while they may be dicta, indicate that the California Supreme Court, if called upon to decide the question presented here, would decide squarely in our favor.

CONCLUSION.

In conclusion we submit that, in view of the foregoing, the judgment of the District Judge should be reversed, with directions to overrule the demurrer and give the appellees leave to answer the complaint, if they so desire; and that appellant should be awarded his costs upon this appeal.

Dated, San Francisco,
May 5, 1916.

REUBEN G. HUNT,
Attorney for Appellant.